



Partnering Strategies: The Legal Dimension

by Ellis Baker

Ellis Baker is a Partner and Head of the Construction & Engineering Practice Group, White & Case, London.

Presentation delivered at the Institution of Mechanical Engineers Conference
"Collaborative Strategies - Partnering and Alliancing for Success" 7 September 2006

Synopsis

The paper examines the concepts of partnering and alliancing and their potential benefits for participants in engineering projects. Given that some advocates of these techniques have argued that they render contracts redundant, the paper considers the feasibility of partnering without a legal framework. Alternatively, the range of contractual arrangements available is explored. The paper also addresses the use of pain/gain share agreements and open book accounting and the specific issue of the feasibility of long-term relationship-building under the EU procurement regulatory regime.

Introduction

The success of the Shajiao 'B' 700 MW power station in Shenzhen in the People's Republic of China is an example of co-operative working arrangements helping to deliver a positive result in the power industry. The conference aims to consider aspects of partnering and alliancing from the point of view of the respective participants and whether they offer opportunities to achieve such results. This paper begins by asking whether partnering/alliancing are an alternative to a legal framework for the project or whether they require special legal provision to be put in place.

The partnering and alliancing concepts

Partnering can be project specific or long term. Both involve the parties to a project, in construction typically the owner/client, the contractor and the consultants, forming a different kind of relationship from the relationship which normally exists under traditional procurement arrangements. The key is the promotion and practice of collaborative working and the use of techniques aimed at encouraging co-operation between the parties. The degree of the relationship can vary considerably across a wide range, from the signature of a statement of goals without more, to, at the other end of the spectrum, full integration of management systems, open-book accounting and sharing of other information and mutual incentivisation. Alliancing is a related concept centred around all the major participants. The term is also used to describe a long-term arrangement, which offers opportunities for benefits to be gained by co-ordinated action and cost-sharing over a number of projects or an ongoing programme.

The benefits of partnering/alliancing

It is not the purpose of this paper to advocate the use of partnering in the power sector or any other industry. It is sufficient to say that there is enough evidence of benefit to justify serious examination of the means of implementation. The UK construction industry has recorded a number of high-profile successes which serve to illustrate the potential benefits available.

When Honda UK won the British Construction Industry Award in 2002 for its new European Car Plant, the judges cited “‘The one team one goal’ culture of openness and transparency”. Honda’s Key Performance Indicator of building cost must have been even more gratifying; the figure of £701 per square metre showed a 40% saving on the (inflation-adjusted) cost of their first plant in Swindon nine years earlier, even more than the 30% improvement sought by Sir Michael Latham in his landmark report ‘Constructing the Team’ in the mid-1990s.

Sir John Egan, Chairman of the Strategic Forum for Construction, in the 2002 consultation paper *Accelerating Change* considered that “the greater efficiencies available from integrating the whole of the team, from clients through to manufacturers, at the earliest practical point is worth re-stating for all.”

Sir John is one of the most powerful voices to speak in favour of partnering and said, in the published *Accelerating Change* report that: “Integrated teams should be based, wherever possible, on strategic partnering. Knowledge and expertise can then be transferred more effectively from one project to the next.” While in individual projects integrated teams can offer their clients “an improved service based on past experience, the ability to innovate and through the development of a culture of continuous improvement.”

Partnering without a legal framework

Sir John and other leading advocates of partnering are known to have favoured a non-contractual approach, on the basis that the spirit in which the parties have agreed to work should avoid conflict; potential disputes could be resolved without confrontation. Some form of statement of intent or charter would be the most that would be needed according to this model. However, not all experience has lent support to this approach.

The Cardiff Bay experience

On 5th May 1997, contractors Birse Construction and clients St David Ltd attended a Team Building Seminar regarding the Adventurers Quay development in Cardiff Bay. They drew up and signed a Partnering Charter, with the overall stated aim:

“To produce exceptional quality development within the agreed time frame, at least cost, enhancing our reputations through mutual co-operation and trust”.

The Partnering Charter contained a statement of detailed intentions:

- To promote an environment of trust, integrity, honesty and openness
- To maximise profit for all parties
- To inspire, design and construct an award winning flagship development
- To enhance the reputation of the team
- To enhance the ethos of Partnering

On November 14th 1997, the parties expressed a “common aim to sign the contract prior to the Christmas break”.

On March 5th 1998, the client notified the contractor of its intention to deduct liquidated damages for delay.

On July 1st 1998, practical completion of Phase 1A was certified.

On August 11th 1998, the contractor left the site. The client treated this as abandonment; the contractor said there was no contract to abandon.

On September 8th 1998, proceedings were issued by the contractor in the Technology and Construction Court (TCC), claiming payment on a quantum meruit in the absence of a contract.

Outcome

The fact that the Cardiff bay project ended with judgment in the TCC in *Birse Construction Ltd v St David Ltd* [1999] BLR 194 is not put forward as proof that partnering is a failed idea. It is not even evidence casting doubt on its validity. However, the issue as to whether an enforceable agreement of any kind existed was certainly disastrous for the parties and a principal cause of, and element in, the litigation. It left open the question as to whether there was an arbitration agreement between them for resolving disputes. It left open the question of the effect, if any, of the partnering charter. It left open the mechanism for payment.

Experiences like this and like those in some other well-publicised partnered project disputes have emphasised the need for certainty. They show the need for any partnering arrangement to be supported by an appropriate legal framework.

Partnering with a legal framework

Traditional contracts

The natural starting point for many parties is to base their partnering arrangement upon a familiar form of contract. They may decide, for example, to enter into a contract on an I Mech E or ICE form and to supplement this arrangement with a partnering charter. Whilst this structure has the benefit of familiarity, care needs to be taken to ensure that the legal consequences of this arrangement are in accordance with the parties’ intentions. The traditional forms of contract are strictly bilateral, so there is no ‘team’ arrangement beyond the partnering charter. Moreover, the partnering charter and the form of contract need to be consistent. Careful drafting of the partnering charter and appropriate amendment to the underlying contract are therefore required. This is so even where the partnering charter is expressed to be non-binding: as noted in *Birse v St. David* such a charter “clearly intended to provide the standards by which the parties were to conduct themselves and against which their conduct and attitudes were to be measured”. The terms of the partnering charter are, therefore, to be taken into account in the interpretation of the contract.

There is an obvious contrast, to put it no more strongly, between the language employed in traditional contracts, which assumes the need to protect the rights of a party against infringement by the other party, and that in a partnering charter, which assumes that all parties are committed to a single goal and to looking after each other’s interests as well as their own. This has led some parties to conclude that a traditional form of contract is not an appropriate starting point for partnering. Thus it is that a number of specialised contractual products have been produced, as well as purpose-built contracts developed for individual partnered projects.

Use of innovative contract forms for partnering

The New Engineering Contract (NEC) was introduced by the Institution of Civil Engineers (ICE) as an alternative to the more traditional engineering forms of contract. Its innovative use of simple language and narrative, and present tense

style attracted those who were critical of the traditional forms, which were seen as inaccessible and legalistic. The NEC was regarded as suitable for partnering arrangements because of its general ethos. Clause 10.1 provides, for example: "The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation. The Adjudicator shall act as stated in this contract and in a spirit of independence." More specifically, the NEC Contract included such features as an early warning system and contemplates the use of a programme as a proactive management tool.

The NEC suite goes further than this. Option X.12, the Partnering Option, is intended for partnering between more than two parties working on the same project or programme of projects. It includes provisions for the creation of a Core Group, the use of common information systems and the payment of incentives upon achievement of Key Performance Indicators (KPIs). Option X.12 is not, however, a multiparty contract. Instead, the client is to enter into a series of bilateral NEC contracts with each participant and with Option X.12 included in a form common to each separate contract. This approach gives rise to difficulties in the enforcement of provisions such as Clause X.12.3 which provides as follows:

"A Partner may ask another Partner to provide information that it needs to carry out work in his own contract and the other party provides it."

A contractor/consultant may not enforce such provisions directly against another contractor/consultant in the absence of any bilateral contract between them. There is also no means for the consolidated resolution of disputes.

Whilst reservations can be expressed about the bilateral structure in Option X.12, NEC has made a significant contribution to the cause of partnering. This has continued with the NEC 3rd Edition which includes a Risk Register for use as a project management tool in the proactive avoidance and management of risk. The NEC 3rd Edition suite also includes a **Term Service Contract** and a **Framework Contract** which may be used as the basis for long term partnering.

The lesser known **Be Collaborative Contract** also includes a Risk Register. A Risk Allocation Schedule is also provided, which enables the parties to allocate the consequences of a risk on a percentage basis instead of allocating the entire consequences of a risk to one of the parties, as would usually be the case. There is also an **ICE Partnering Addendum**, published in 2003, for use with the latest editions of the ICE's bi-party engineering and consultancy agreements, which adopts a similar approach to NEC Option X.12.

In concluding this brief review of contractual products available for consideration for use on partnered projects, reference should be made to those prepared by the Association of Consultant Architects (ACA) for use in construction projects.

PPC 2000 is the ACA Standard Form of Contract for Project Partnering and is a multiparty partnering contract. In 2003, the authors claimed that in its first 2½ years of use it had been adopted on projects with a value of over £5 billion. Its purpose, as stated in the ACA Guide, is to act as "a process document, commencing at the earliest point in the formation of a team and acting as a hub to describe the practical working relationships between project team members and the practical processes necessary to develop designs, manage risk, formulate a full supply chain and procure a completed project".

SPC 2000 is the ACA Standard Form of Specialist Contract for Project Partnering, which is intended to be entered into between the Contractor and its Specialist Sub-Contractors. SPC 2000 is intended for use with PPC 2000, because the latter does not deal with sub-division of performance and supply of sub-division of the performance and supply of services, works and goods by specialist sub-consultants, sub-contractors and suppliers or with sub-division of payments to them by the contractor.

TPC 2005 is the ACA Standard Form of Contract for Term Partnering, being the equivalent of the NEC Term Service and Framework Contracts.

Specific issues in Partnering/Alliancing

Pain/Gain Sharing Agreements

One of the techniques used in collaborative arrangements to encourage co-operative working is the Pain/Gain sharing agreement, whereby the parties can both (all) achieve benefits by efficient working and agree to share, or at least pre-allocate, the consequences of failure to meet KPIs. These techniques can provide effective incentives to the parties, but the case of *Alstom Signalling Ltd v Jarvis Facilities Ltd* [2004] EWHC 1285 is a reminder that the legal machinery to make them work must be put in place; the provisions will not be implied from the parties' intentions.

The parties had begun to work out the Pain/Gain Share agreement:

If the 'Final Cost/Price' came in below the adjusted 'Target Cost/Price', the gain would be shared by Railtrack (the client), Alstom (the contractor) and the sub-contractors, of whom Jarvis was one.

If the Final Cost/Price was up to £500,000 above the Target Cost/Price, Alstom and Railtrack would share the initial 'pain'.

However, the dispute which came to the TCC was over the extent to which Jarvis, to whom much of the work was sub-contracted, had agreed to participate in losses above this figure. The parties had agreed that the Pain/Gain Share arrangements should extend to the sub-contract but had been insufficiently specific as to how they would operate there. In the end, the pain/gain share mechanism failed and Alstom's argument that it should be regarded as an essential implied term failed too.

Open book accounting

In circumstances where the whole or part of the contractor's reimbursement is based on actual expenditure, it is assumed that the employer is entitled to see the Contractor's books and payment records to verify the expenditure claimed. There are two main reasons for this. First, it is an essential part of the spirit of trust and co-operation that one of the parties is not concealing information from the other to try to obtain an advantage. More specifically, open book accounting is intended to eliminate or at least reduce the scope for contentious claims, which overcome some projects run under traditional contracts, since the employer will only be paying on the basis of objectively verifiable evidence and not seeking to resist a skilfully constructed claim.

Alliancing and restrictions under EU Procurement law

The EU procurement regulations governing most public sector and utilities contracts of any significance have long been regarded as imposing severe restrictions upon the use of partnering or alliancing agreements on a long term basis. The EU public procurement regulatory regime has at its heart the principle of open competitive tendering for all contracts within its scope. The formation of longer term relationships embracing a series of projects is, accordingly, contrary to this principle.

The benefits that can be obtained from industries seeking to move towards more efficient and less confrontational methods of procurement and in developing long term relationships has, however, also been recognised by the EU. Framework agreements were recognised in the utilities sector and given very restrictive recognition in other areas of public procurement. The more liberal arrangements for utilities have recently been extended to other areas of public procurement. The current regime, as incorporated into English law, is reflected in the Utilities Contract Regulations 2006 and the Public Contracts Regulations 2006 which came into force on 31 January 2006.

Under these new regulations, a utility or public body may award a contract under a framework agreement without a call for competition, provided that the framework agreement itself was awarded after a call for competition. A framework agreement is defined as a contract which establishes the terms upon which a utility or public body may enter into subsequent contracts and may be entered into with one or more service providers.

Conclusions

Partnering has a contribution to make in procurement of construction and services in engineering projects for appropriate parties in appropriate projects. One size does not fit all. If partnering or alliancing arrangements are entered into, they need to be underpinned by suitable legal structures. The *Birse* and *Alstom* cases provide salutary reminders of the consequences of failure to do so. Expressions of positive intention at the outset cannot alone guarantee successful conclusion of a project without conflict.

If you would like to discuss any of the issues raised in this paper in more detail please contact:

Ellis Baker
Partner
White & Case
5 Old Broad Street
London EC2N 1DW

Telephone: +44 20 7532 1601
Email: ebaker@whitecase.com

www.whitecase.com

White & Case LLP, a New York State registered limited liability partnership, is engaged in the practice of law directly and through entities compliant with regulations regarding the practice of law in the countries and jurisdictions in which we have offices.

ALMATY ANKARA BANGKOK BEIJING BERLIN BRATISLAVA BRUSSELS BUDAPEST DRESDEN DÜSSELDORF FRANKFURT HAMBURG
HELSINKI HONG KONG ISTANBUL JOHANNESBURG LONDON LOS ANGELES MEXICO CITY MIAMI MILAN MOSCOW MUMBAI MUNICH
NEW YORK PALO ALTO PARIS PRAGUE RIYADH SÃO PAULO SHANGHAI SINGAPORE STOCKHOLM TOKYO WARSAW WASHINGTON, DC
